No. 07-187

IN THE SUPREME COURT
OF THE UNITED STATES

GORDON DAVENPORT,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

The Government concedes the circuit split over whether the res judicata effect of a prior adjudication of tax liability against a transferor precludes an alleged transferee from litigating his transferee status or the value of the property transferred to him in a subsequent transferee liability proceeding. It insists, however, that the split is (1) narrow, involving only two circuits, and (2) unimportant, involving an issue unlikely to recur. Both contentions are wrong. First, the Fifth Circuit's decision conflicts with the holdings of at least three other circuits and the Tax Court, and the Government's efforts to distinguish these holdings are unavailing.

Second, the issue over which the circuits have split is likely to recur. The Fifth Circuit's ruling, which is squarely in the teeth of this Court's longstanding preclusion precedent, gives the Government a free pass in its future transferee liability cases by eliminating its statutory burden of proof in all such cases where there has been a prior adjudication of transferor tax liability. Absent review by this Court, the Government can bring transferee liability prosecutions in the Fifth Circuit without facing its burden of proof, which threatens the constitutional and congressional mandate for uniform application of the Tax Code. Certiorari should be granted.

1. This case involves a circuit split of ongoing importance.

The Government's contention that the circuit split created by the Fifth Circuit's ruling implicates only the Fifth and Tenth Circuits is wrong. As demonstrated in the Petition, the Fifth Circuit's ruling also conflicts with the decisions of numerous other courts, and the Government's efforts to distinguish those cases are unavailing.

The Government attempts to distinguish *Pert v. Commissioner*, 105 T.C. 370 (1995), which held that res judicata did not preclude litigation of "whether Pert was a transferee," by arguing that determining whether Pert was a transferee was necessary to determine whether he was in privity with the taxpayer—an element of res judicata. Opp. 14-15. The Government claims that the Fifth Circuit's ruling similarly "would not have prevented [Davenport] from litigating his status as a transferee." Opp. 15. This analysis is flawed in several respects.

First, the Government overlooks that *Pert* did not merely permit litigation of "whether Pert was a transferee"; it also permitted litigation of "*to what extent*" Pert was a transferee—i.e., the value of the property he received from the taxpayer. *Pert*, 105 T.C. at 371 (emphasis added). This is the *very issue* the Fifth Circuit prevented Davenport from litigating.

Second, contrary to the Government's contention, the Fifth Circuit did *not* permit Davenport to challenge his transferee status, but rather held that it

was established by res judicata. The Government argued,[1] and the Fifth Circuit held, that Davenport was a transferee because "[t]he tax court concluded [he] was a transferee, and the Tenth Circuit affirmed that decision." Pet. App. 15a.[2]

Accordingly, the Fifth Circuit's decision conflicts with the holding in *Pert*. The Government's attempts to distinguish *Baptiste v. Commissioner*, 29 F.3d 1533 (11th Cir. 1994), based on the same grounds as *Pert*, are likewise unavailing. Opp. 16.

The Government next seeks to distinguish *First National Bank v. Commissioner*, 112 F.2d 260 (7th Cir. 1940), which held that, notwithstanding a prior adjudication of the taxpayer's tax liability, the purported transferee was "entitled upon the most fundamental principles to his day in court and a hear-

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[1] In its opening brief, the Government argued that "the fact that [Davenport] received a gift was established under the doctrine of *res judicata* by the Tax Court decision." Appellant's Br. at 29.

[2] The Government wrongly contends that Davenport concedes his transferee status, relying on his acknowledgment that an alleged transferee is in "privity" with the taxpayer to the extent that he cannot challenge a prior adjudication of the taxpayer's tax liability. Opp. 15. It does not follow from this acknowledgment that Davenport concedes transferee status as a factual matter. Davenport is a "transferee" within the meaning of the Tax Code only to the extent that he is a "donee"—i.e., the recipient of a gift. 26 U.S.C. § 6901(h). As Davenport argued in summary judgment briefing, the stock interest he received constituted a gift only if its value exceeded the $804-per-share purchase price he paid for the interest. R.788-789. In contesting the value of the stock interest, Davenport also necessarily contested his transferee status.

ing" on whether he had "received property as transferee sufficient to discharge the liability." *Id.* at 262. The Government argues that, because *First National Bank* involved transferee liability based on income tax rather than gift tax, "the value of the property received by the transferee could not have been determined in the action that established the income tax deficiency." Opp. 16. This is wrong. The value of the property transferred is potentially every bit as relevant to a determination of income tax liability as it is to gift tax liability. If, for example, the property allegedly transferred is a non-cash asset that the Government contends constituted income to the transferor, then the value of the asset would be relevant to the determination of income tax liability and thus would have been determined in the prior tax adjudication.[3]

If the Government were correct that application of res judicata hinges on the question of whether the value of the property transferred was or could have been determined in the tax liability proceeding, then presumably the courts holding that res judicata precludes the transferee's relitigation of the transferor's tax liability would have addressed that question. Yet none of the courts have done so, instead concluding that the alleged transferee is "of course" entitled to litigate transferee status and the value of the

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[3] Likewise, the transferor might claim that he transferred assets to a transferee at a loss in connection with an arms' length business transaction and that his taxable income (and associated tax liability) should be reduced on account of the loss, which would necessitate litigating the value of the transferred property in the tax liability proceeding.

property transferred. *First Nat'l Bank*, 112 F.2d at 262. The Fifth Circuit's holding is in conflict with the holding of these courts.[4]

The Government also contends that the issue on which the Fifth Circuit's holding creates a conflict is unlikely to recur, claiming that it is "not aware of any previous case that has involved the issue nor of any pending case that presents it." Opp. 17. As noted above, numerous other courts have considered whether res judicata prevents an alleged transferee from litigating transferee status or the value of property transferred. Until the Fifth Circuit's ruling, they uniformly answered "no." Given the previous uniformity of decision on the issue, the lack of any other current cases presenting it is unsurprising. The courts' holdings that alleged transferees are "of course" entitled to litigate these fact issues are a telling indication that the Government has not heretofore seriously challenged their right to do so.

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[4] The Government places much stock in the fact that *Pert* and the other cases Davenport cites specify res judicata as the preclusive doctrine on which they rely to prevent the alleged transferee from relitigating the transferor's tax liability. Opp. 14-16. As noted in Davenport's Petition, the reason for this characterization is that, while the transferor's tax liability is an independent *claim* against the transferor, it is merely a single *element* of the § 6324 claim against the alleged transferee. Pet. 19 n.12. It does not follow from this characterization, as the Government suggests, that the § 6324 claim's inclusion of the transferor's tax liability as one of its *elements* establishes that the tax liability claim against the transferor constitutes the *same claim* as the § 6324 claim against the transferee, such that res judicata also precludes the transferee from litigating elements of the § 6324 claim *other than the transferor's tax liability*.

Indeed, the Government raised such a challenge here only after the district court ruled that it lacked any competent evidence with which to carry its burden of proving the value of the property Davenport received. R.1728.

If allowed to stand, the Fifth Circuit's erroneous application of res judicata will allow the Government to deprive a § 6324 defendant of the right to litigate the transferee status and transfer value elements of the transferee liability claim in *every case* in which the transferor's tax liability was previously adjudicated—a common scenario given that the transferor's failure to pay the tax when due is a condition precedent to the imposition of transferee liability. *See* 26 U.S.C. § 6324(b). The Fifth Circuit's position relieves the Government of its burden under the Tax Code of proving these additional elements of transferee liability. Review by this Court is necessary to prevent erroneous and inconsistent application of the Tax Code, as well as misapplication of fundamental preclusion principles articulated by this Court.

2. The Government's contention regarding the inapplicability of the Tax Code's allocation of the burden of proof is groundless.

The Government insists that the Fifth Circuit's decision is not inconsistent with § 6902(a) of the Tax Code, which allocates the burden of proof on the relevant elements to the Government, because § 6902 applies only to proceedings in the Tax Court

and the Government filed this suit in district court.[5] In other words, the Government argues that it bears the burden of proving transferee liability when the alleged transferee sues it in Tax Court to challenge a notice of transferee liability, but if the Government sues the alleged transferee in district court, the burden inexplicably shifts to the alleged transferee.

The lack of bona fides in the Government's contention is best evidenced by the fact that the Government's own proposed jury questions in the district court asked, "Has the United States proved by a preponderance of the evidence that the value [of the

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[5] The Government cursorily argues that the Court cannot consider whether the Fifth Circuit's ruling contravenes the Tax Code's allocation of the burden of proof because this matter was raised for the first time below in a motion to stay the mandate. This position stands in marked contrast to the position the Government took below, where it claimed that the "bulk of Davenport's motion [to stay] merely repeats arguments already rejected by this Court." May 25, 2007 Letter from Government to Fifth Circuit. Also, Davenport argued in his opening brief below that the Government invoked res judicata "to relieve itself of the obligation to prove . . . element[s] of its case." Appellee's Br. at 31. In any event, while it is true that this Court will "not decide in the first instance issues not decided below," *National Collegiate Athletic Ass'n v. Smith*, 525 U.S. 459, 470 (1999), Davenport does not ask the Court to decide any such issue. The sole issue Davenport asks the Court to decide is whether the res judicata effect of a prior tax liability adjudication precludes an alleged transferee from litigating transferee status or the value of property transferred in a subsequent proceeding under § 6324. The Fifth Circuit obviously decided this issue. The evisceration of the Tax Code's allocation of the burden of proof is a consequence of the Fifth Circuit's resolution of that issue which the Court can and should consider in determining whether the issue is worthy of review.

stock Davenport received] was $2,730 per share?" R.1567. The Government likewise never challenged the district court's final summary judgment, which was based on the Government's lack of competent evidence to prove the value of the stock interest Davenport received, on the ground that the Government did not bear the burden of proof on this issue.

The sole authority the Government cites in support of its new position on the burden of proof is *United States v. Janis*, 428 U.S. 433 (1976), in which this Court held that the taxpayer bore the burden of proof in a tax collection action initiated by the Government in district court. The Government claims that a transferee's liability under § 6324 is a tax liability, and, therefore, that the alleged transferee bears the burden of proof just as a taxpayer would. Opp. 12. This argument is unavailing.

First, this Court concluded in *Janis* that the taxpayer should bear the burden of proof in the district court collection action because this accorded "with the burden-of-proof rule which prevails in the usual preassessment proceeding in . . . Tax Court." *Id.* at 440. Applying the same rule in this case, *Janis* dictates that the burden of proof in district court transferee liability proceedings rests *on the Government* because this accords with the burden-of-proof rule which prevails in Tax Court transferee liability proceedings.

Second, the premise underlying the Government's argument—that transferee liability under § 6324 is a tax liability—is wrong. As the Eleventh Circuit concluded in *Baptiste*, on which both the Fifth Circuit

and the Government rely, transferee liability under § 6324 "is *not* a tax liability, but rather an independent liability." *Baptiste v. Comm'r*, 29 F.3d 1533, 1541 (11th Cir. 1994) (emphasis added).[6] No basis exists for allocating the burden of proof inconsistently with § 6902.[7]

The Fifth Circuit's ruling eliminates the Government's statutory burden of proof in transferee liability cases. Certiorari is warranted to ensure correct and consistent application of the Tax Code.

3. The Government cannot justify the Fifth Circuit's departure from basic principles of claim and issue preclusion.

Finally, the Government insists that its transferee liability claim against Davenport is the "same

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[6] The Eleventh Circuit observed that, "[w]ere transferee liability under section 6324[] a tax liability, there would be no need for the authorizations and provisions of section 6901(a)," which establish a procedure for assessment, payment and collection of transferee liabilities in the same manner as tax liabilities. *Id.*

[7] The Government also argues that the estate's stipulation to the stock value in the tax liability proceeding renders the difference in burden of proof in the transferee liability case irrelevant for res judicata purposes. Opp. 12. First, this contention ignores the reality that a party is far more likely to accept an unfavorable "compromise" stipulation on an issue if the party bears the burden of proof on the issue than if it does not. Second, the underlying premise of the Government's argument—that res judicata should preclude litigation of issues if they were *stipulated* in a prior action *but not if they were actually litigated*—is devoid of any logical or legal foundation. Third, accepting the Government's argument would discourage parties from stipulating to anything in a tax liability case.

claim" for res judicata purposes as the tax liability claim against Birnie's estate, even though Davenport was not a party to the Tax Court proceeding where the latter claim was adjudicated, because Davenport is in privity with the estate.[8] The Government acknowledges this Court's holding in *Montana v. United States*, 440 U.S. 147 (1979), that determining the preclusive effect of a judgment upon a non-party who controlled the action necessarily "falls under the rubric of collateral estoppel rather than res judicata" because the claim asserted against the non-party "differs by definition" from the claim adjudicated in the prior action. *Id.* at 154. The Government insists, however, that *Montana* is inapplicable because it addressed "preclusion against non-parties who are subject to preclusion because they assumed control of [prior] litigation," whereas this case involves "preclusion against parties who are in privity with a party to the prior judgment." Opp. 10 (internal quotation marks and alterations omitted). This is a distinction without a difference.

"Privity" is nothing more than "a shorthand designation for those persons who have a sufficiently close relationship with the record parties to be bound by the judgment." *Living Care Alternatives of Kirkersville, Inc. v. United States*, Nos. 05-4418, 06-3163, 06-3166, ___ F.3d ___, ___, 2007 WL 2566032, at *10

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[8] The Government insists, based on an isolated, uncited per curiam court of appeals opinion, that the Tax Court had discretion to allow Davenport to intervene. Opp. 10-11. There is substantial contrary authority (Pet. 24), but in any event, no basis exists for concluding that the mere possibility of intervention creates an identity of claims for res judicata purposes.

(6th Cir. Sept. 5, 2007) (citation omitted). "A variety of relationships between two parties can give rise to the conclusion that a nonparty to an action is 'in privity' with a party to the action for purposes of the law of judgments . . . ." *Int'l Nutrition Co. v. Horphag Research, Ltd.*, 220 F.3d 1325, 1329 (Fed. Cir. 2000). The circumstance in *Montana*—litigation controlled by a non-party—is one such relationship. *See Living Care*, 2007 WL 2566032, at *10 (noting that the relationship between a party and "a nonparty who controlled the original suit" constitutes one of the "categories of privity"). The circumstance here—an alleged transferor-transferee relationship between the party and non-party—is another. The Government fails to explain why *Montana*'s holding does not apply with equal force here simply because a different type of relationship creates privity.

Montana makes clear that, because Davenport was not a party to the Tax Court proceeding in which Birnie's tax liability was adjudicated, the transferee liability claim against him cannot be the same claim as the tax liability claim against Birnie's estate. Accordingly, res judicata cannot apply. Review is warranted to correct the Fifth Circuit's fundamental departure from this Court's previously settled preclusion precedent.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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